

alternative to the incumbent LEC, then and only then, will Section 271(c)(1)(A) be satisfied.

Congress recognized that Section 271(c)(1)(A) is unlikely to be satisfied immediately upon State Commission approval of an interconnection agreement. The Conference Report statement quoted above, that a carrier must be "operational" before the BOC can be understood to be providing access and interconnection, supports this view. Moreover, Section 271(c)(1)(B)(ii) also demonstrates the point. That provision essentially states that a BOC need not meet the requirements of Section 271(c)(1)(A) if the only facilities-based carrier to whom it is providing interconnection and access services "violates the terms of an agreement approved under Section 252" by failing to comply with "the implementation schedule contained in such agreement." The implication is that Section 271(c)(1)(A) is not satisfied until, at the very least, the implementation schedule in an interconnection agreement has been completed. This general recognition that compliance with Section 271(c)(1)(A) might take time is logical in light of the requirement that one or more competitors provide service predominantly over their own networks.

II. It Would be Inconsistent with the Public Interest, Convenience and Necessity to Certify that SWBT Has Met the Requirements of Section 271(c)

A. Allowing SWBT to Enter the In-Region InterLATA Market Prematurely Would Remove SWBT's Incentive to Open Its Local Market to Competition

Congress determined that no BOC should be allowed entry into the interLATA market within its region until it has relinquished its monopoly stranglehold over the local

exchange markets on a state-by-state basis. Since this has not been done in Oklahoma, it would violate the public interest to permit SWBT in-region, interLATA relief in Oklahoma.

The public interest reasons for this requirement are multifold. First, interLATA entry is the only incentive which can be given to a BOC to cooperate in opening its local monopoly. Absent holding out the "carrot" of interLATA entry, no BOC would rationally relinquish its bottleneck and voluntarily aid in bringing about competition.³² The readily observable conduct of GTE in the wake of efforts by this Commission and the Federal Communications Commission to establish competitively neutral rules for interconnection, demonstrates this point succinctly.³³ As the CEO of Ameritech Corp., so aptly stated: "The big difference between us and them [GTE] is they're already in long distance. What's their incentive to cooperate?"³⁴

SWBT must persuasively demonstrate to the Commission that the competitive checklist of Section 271 has, in fact, been "fully implemented."³⁵ For example, SWBT has advised Sprint that it expects to implement the FCC's electronic interface requirement on schedule on January 1, 1997, but this is inadequate as a matter of law and not credible as a matter of common sense. The difficulties of implementing interface bonding will not

³² See Phelan Testimony at 3. As the FCC has found:

incumbent LECs have no economic incentive, independent of the incentives set forth in sections 271 and 274 of the 1996 Act, to provide potential competitors with opportunities to interconnect with and make use of the incumbent LEC's network and services.

FCC Interconnection Order at ¶ 55.

³³ See, "Holding the Line on Phone Rivalry, GTE Keeps Potential Competitors, Regulators" Price Guidelines at Bay" Washington Post, October 23, 1996, at C12.

³⁴ Id. at C14.

³⁵ See 47 U.S.C. § 271(d)(3)(A)(i).

be fully known until the parties actually attempt it; electronic interface will not in fact be "fully implemented" as required by the statute until it is demonstrably used and useful to the parties. Had Congress thought it sufficient that a BOC merely promise or even legally commit to certain action as a precondition to entry, it could have and would have written this into law. Instead, what Congress has mandated is that the checklist be "fully implemented." This SWBT has plainly not done. And, as Congress wisely foresaw, once SWBT is allowed to "eat the carrot," it will have little if any incentive to fulfill its commitments.

There are, of course, other public interest considerations that weigh heavily against the granting of interLATA authorization at this time. Without adequate competition established at the local exchange level, there will be no market disciplining effect on SWBT to refrain from anti-competitive conduct in the interLATA market. As described by FCC Chief Economist Joseph Farrell:

The BOCs' incentives and ability to discriminate against rivals in long-distance -- to take the most prominent example of MFJ prohibitions -- depend on their market power in the local bottleneck. If we can open up the bottleneck and implement vigorous competition there, then BOCs will have little or no incentive to raise the costs of their long-distance partners - - and if they do so, those long-distance carriers and their customers will have other choices, so the harm to consumers will be limited. Thus, when there is enough competition in what is now the local bottleneck, it will make good sense to let the BOCs into complementary businesses such as manufacturing and long distance.³⁶

Discrimination and cross-subsidization remain serious threats to the interLATA competitive market. While this Commission will undoubtedly be diligent in monitoring for

³⁶ Farrell, Joseph, "Creating Local Competition," (speech as prepared for delivery) May 15, 1996, Washington, D.C. at 6.

this type of misconduct, the anti-competitive opportunities available to SWBT will be virtually countless. It need only adversely adjust any one of large numbers of access "details"" and thereby seriously disrupt the interLATA market.

SWBT could also mask its behavior in ways that will be difficult to remedy.³⁷ All of this hurts not only competition, but consumers who otherwise reap the benefits of the competitive process. Local ratepayers are forced to subsidize the competitive ventures of the BOCs. Even if SWBT's rates do not increase, the competition that would have driven costs down (and, in the end, prices) is absent. Second, consumers of competitive interLATA services are saddled with less efficient products and services because the market share of more efficient firms has been displaced by SWBT -- not by better service but by misconduct.

For these reasons, the public interest requires that SWBT not be authorized to provide in-region interLATA services at this time. The promise to help bring about local competition cannot be mistaken for competition itself. The Commission must hold SWBT to its word, and then "verify" that it has in fact kept its word and further, "verify" that the intended results of competitive effects are observable, before interLATA relief can be granted.

³⁷ See Phelan Testimony at 7-10; 23-29. The FCC's Chief Economist has stated that "[t]hese problems are hard to regulate away, because the withdrawal of cooperation from rivals may be subtle, shifting, and temporary, but yet have real and permanent effects. . . ." Farrell, Joseph, "Creating Local Competition," (speech as prepared for delivery) May 15, 1996, Washington, D.C. at 5.

B. The Public Interest, as That Phrase is Used in Section 251(d)(3)(C), Requires the Presence of Viable Local Competition in at Least all Major Markets Within the State of Oklahoma

It is plain that Congress did not intend to allow BOC interLATA entry upon the mere showing of highly localized, insignificant entry. While Congress chose not to await statewide competition before allowing BOC authorization, it is appropriate to consider other markets throughout the State.

In assessing the adequacy of interconnection arrangements, the Commission needs to consider not only the presence of competitors in Oklahoma City and Tulsa³⁸, but other significant areas of commerce and population. The competitive arrangements in Oklahoma City and Tulsa relied upon by SWBT must necessarily be available and workable in other parts of the State. As the House Report explained the section in the House bill that evolved into Section 271(c)(1)(A):³⁹

whatever agreement the competitor is operating under must be made generally available throughout the State. Any carrier in another part of the State could immediately take advantage of the "agreement" and be operational fairly quickly. . . .⁴⁰

The House thus deemed this would:

³⁸ See SWBT Brief, p. 8, wherein SWBT relies upon Brooks Fiber's representation that Brooks Fiber is providing local service in Tulsa and Oklahoma City as proof of local exchange competition.

³⁹ The Conference Report's ultimate adoption of Section 271 relied nearly exclusively upon the House evolution of that section. All versions of the House bill, from introduction, through Committee, to the substitute amendment approved on the House floor, contained the relevant requirement for the BOC to show an interconnection agreement with a competitive provider of local exchange service, and thus the House legislative history in this regard is authoritative.

⁴⁰ House Report at 77.

creat[e the] potential for competitive alternatives to flourish rapidly throughout a State, with an absolute minimum of lengthy and contentious negotiations once an initial agreement is entered into. . . .⁴¹

The issue, then, is not whether other local markets in the State are relevant, but rather what weight one must give to them. This is not an issue that needs to be decided here, however, because SWBT's submission falls far short of establishing compliance for Oklahoma City and Tulsa alone.

Sprint submits that not only should this Commission consider the competitive evolution of other markets within Oklahoma, but it should also examine and weigh the prospects for competitive entry in other states in which SWBT now enjoys enduring market power. This is especially relevant because a significant fraction of calls both originate and terminate in SWBT's region. This circumstance, in effect, gives SWBT two bites at the apple to slow the advent of competition, whether through manipulation of access charges, discrimination, or cross-subsidization.

III. CONCLUSION

For the reasons set forth above, Sprint respectfully requests that the Commission make a finding and recommend that SWBT is not yet eligible for entry into interLATA services under the Track A and Track B provisions of Section 271(c)(1); that SWBT has not yet met the requirements of the competitive checklist in Section 271(c)(2); and that SWBT's current entry into interLATA services would not increase the competitiveness of

⁴¹ Id.

local exchange markets, increase the choices available to Oklahoma consumers, or serve the public interest.

Respectfully submitted,

SPRINT COMMUNICATIONS COMPANY, L.P.



Ellen A. D'Amato
Martha Jenkins
8140 Ward Parkway, 5E
Kansas City, MO 64114
(913) 624-6184

Sue D. Blumenfeld
Thomas Jones
WILLKIE FARR & GALLAGHER
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20036
(202) 328-8000

ITS ATTORNEYS

Dated: March 10, 1997.

BEFORE THE CORPORATION COMMISSION OF THE
STATE OF OKLAHOMA

Application of Ernest G. Johnson,)
Director of the Public Utility)
Division Oklahoma Corporation) Cause No. PUD 9700000064
Commission to Explore the)
Requirements of Section 271 of)
the Telecommunications Act of 1996)

**TESTIMONY OF
EDWARD K. PHELAN
ON BEHALF OF
SPRINT COMMUNICATIONS COMPANY L.P.**

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SPRINT COMMUNICATIONS COMPANY L.P.**

QUALIFICATIONS

1 **Q. Please state your name, employer, address and position.**

2 A. My name is Edward K. Phelan. I am employed by Sprint Communications Company L.P.
3 ("Sprint") as Staff Director, Regulatory Policy and Coordination. My address is 8140
4 Ward Parkway, Oklahoma City, Missouri 64114.

5 **Q. Please describe your educational background and work experience.**

6 A. I have a Master of Arts degree in economics from Indiana State University. I hold a
7 Bachelor of Science degree in economics from Lewis University. I have been employed
8 by Sprint since November 1992. Before joining Sprint, I was Chief Economist for the
9 Indiana Utility Regulatory Commission, beginning in June of 1989. Prior to that, I held
10 the position of Assistant Chief Economist and Principle Utility Analyst. I was employed
11 by the Indiana Department of Commerce in economic planning and research positions
12 from 1974 through 1982

13 My present responsibilities include coordinating with representatives of Sprint business
14 units regarding regulatory matters, contributing to the development of Sprint regulatory
15 policy, and testifying on behalf of Sprint concerning economic and regulatory policy
16 matters in telecommunications. I have participated in regulatory proceedings before the
17 following state commission: Arizona, California, Hawaii, Illinois, Indiana, Michigan,
18 Montana, New Mexico, Ohio, Oregon, Utah, and Wisconsin.

19

1 **SUMMARY OF TESTIMONY**

2 **Q. What is the purpose of your testimony?**

3 **A. My testimony provides a framework for addressing the economic and public interest**
4 objectives that should be considered by the Oklahoma Corporation Commission
5 (Commission) as it gathers information to assist in its verification of Southwestern Bell
6 Telephone Company's (SWBT) compliance with Section 271(a) when SWBT files with
7 the Federal Communications Commission (FCC) its application to provide in-region
8 interLATA services.

9
10 **Q. What are your major conclusions?**

11 **A. My primary conclusion is that interconnection agreements must be demonstrated to be**
12 working in practice on a commercial scale before checklist compliance can be regarded
13 as economically meaningful, and in order to meet the public-interest standard for
14 approving Section 271 applications. SWBT's submission shows that it has not yet begun
15 providing interconnection to a competitor or set of competitors that represent significant
16 facilities-based alternatives.

17 There is widespread agreement that the public interest will be served if states and the
18 Federal Communications Commission (FCC) take advantage of the historic opportunity
19 provided by the 1996 Telecommunications Act to ensure that local telephone markets are
20 opened up to competition. Because these markets are currently monopolized, economics
21 tells us introducing competition into them offers potentially large social gains. To open

1 these markets will require ongoing, extensive, and detailed cooperation from incumbent
2 local exchange carriers (ILECs). No monopolist lightly relinquishes its dominant
3 position. Recognizing this, Congress provided a powerful incentive for Bell Operating
4 Company (BOC) cooperation by providing conditions necessary for BOCs to enter
5 interLATA markets.

6 It would be a mistake to relinquish the Section 271 lever until local markets are
7 demonstrably open. If Section 271 authorization is granted before we are confident that
8 the required BOC cooperation has indeed been forthcoming and will continue, the strong
9 incentives for BOC cooperation created by the 271 process will be lost, and the
10 emergence of local competition will be undermined. This situation would be difficult to
11 rectify, because Section 271 approval would be virtually impossible to reverse. On the
12 other hand, if Section 271 approval is deferred until interconnection has been proven to
13 work, such approval can then be granted quickly once local competition is enabled.
14 Thus, uncertainty favors erring on the side of caution and withholding approval until
15 interconnection has been clearly demonstrated.

16 Premature approval of Section 271 applications is especially dangerous because
17 competitive LECs (CLECs) are so reliant on BOCs to gain even a foothold in local
18 markets, and since the required cooperation is so multifaceted and complex. Because of
19 these complexities, regulatory oversight will necessarily be highly imperfect, especially
20 until procedures have been ironed out and interconnection has been proven to work in
21 practice. To approve SWBT's Section 271 application before the highly intricate and

1 complex interconnection relationships between SWBT and CLECs have been
2 demonstrated to work runs the risk of prematurely eliminating the major incentive for
3 SWBT to cooperate with its would-be rivals.

4 Checklist compliance, if it truly is to mean that local competition has been enabled, must
5 require more than an agreement that exists only on paper. Economically meaningful
6 checklist compliance requires that interconnection be shown to be working in practice.
7 Very likely, the first interconnection agreements to be operationalized on a significant
8 scale in Oklahoma will involve the resale of SWBT's retail services. Sprint is planning
9 to begin as a CLEC in Oklahoma through resale. Thus, the first significant indication
10 that interconnection is working in practice in Oklahoma will occur when resellers are able
11 to achieve operational parity with SWBT. (The testimony of Cynthia K. Meyer provides
12 greater detail regarding Sprint's business plans and SWBT's failure to provide operational
13 parity.)

14 Of course, resale competition is not as powerful a force for consumer choice as is
15 facilities-based competition, and Congress put some specific requirements in the Act
16 stressing the key role of facilities-based competitors in local exchange markets. When
17 resale is proven to work in practice, and if CLECs have confidence that the regulatory
18 environment will be conducive to competition, they will be willing to make the substantial
19 sunk investments necessary to provide real, facilities-based local competition. Even after
20 such investments are made, however, it will remain important for the Commission to
21 continue to press SWBT to cooperate with CLECs who are investing in fiber optic

1 networks, switches, etc., to ensure that these investments are not stranded nor degraded,
2 but rather form the basis for genuine new choices for consumers.

3 I base my conclusions on an economic analysis of the conditions of entry into local
4 exchange markets. Since not even SWBT can argue that there is widespread local
5 exchange competition throughout Oklahoma, my analysis focuses on the prospects for
6 competition in local exchange markets in Oklahoma, and the barriers to entry into those
7 markets. Until the barriers are definitely down, however, and actual competitors are
8 observable in the market, there remains a very real risk that Section 271 authorization
9 will adversely affect the emergence of local competition, by removing much of the
10 pressure on SWBT to cooperate with CLECs. This would be contrary to the public
11 interest.

12
13 **ECONOMIC OBJECTIVES IN 271 APPLICATIONS: GENERAL PRINCIPLES**

14 **Q. Describe the factors that should be evaluated in assessing whether in-region**
15 **interLATA authorization for SWBT would be consistent with the public interest,**
16 **convenience, and necessity.**

17 **A.** There are four major economic and policy objectives that must be balanced in evaluating
18 BOC Section 271 applications to offer in-region long-distance service. Ultimately,
19 determining whether in-region interLATA authorization for SWBT would be consistent
20 with the public interest, convenience, and necessity turns on the impact of authorization
21 in these four areas. These factors are: (1) expansion of consumer choice in local

1 markets; (2) providing additional competition in interLATA markets; (3) preventing
2 anticompetitive conduct in the provision of exchange access; and (4) leveling the playing
3 field as markets merge.

4
5 **Q. What is the relationship between 271 applications and your first factor, expansion**
6 **of consumer choice in local markets?**

7 **A. The 1996 Telecommunications Act provides an historical chance to open up local**
8 **exchange markets, which are the most significant remaining bottleneck monopolies in the**
9 **telecommunications sector. If our experience in long-distance markets is any guide, the**
10 **introduction of competition into local exchange markets will generate substantial**
11 **consumer benefits in the form of new services and lower prices.**

12 Introducing competition into local exchange service will require the cooperation of the
13 incumbent local exchange carriers (ILECs). This cooperation is unlikely to be voluntary:
14 No monopolist, regulated or not, is keen to relinquish its dominant position.

15 Of course, this Commission has some authority to compel SWBT to cooperate with
16 would-be competitive local exchange carriers, at least along some well-defined and
17 observable dimensions. But direct regulation of SWBT's conduct in and of itself will not
18 be enough. There is too much scope for SWBT to get around the spirit if not the letter
19 of the interconnection rules, and to impose its own interpretation of its interconnection
20 duties, at least until many aspects of interconnection are tested in practice and understood
21 by competitive local exchange carriers as well as the Commission.

1 So long as Section 271 authorization remains pending, SWBT has incentives to fix
2 problems with CLECs in a hurry; once Section 271 authorization is granted, SWBT will
3 have fewer incentives quickly to resolve disputes over the myriad details of
4 interconnection, although CLECs will remain heavily dependent upon SWBT. This
5 highly asymmetric situation is simply not as conducive to resolving the many
6 interconnection issues vital to making local exchange competition a reality.

7 The implication of this analysis is that the path to genuine local competition will be far
8 smoother if SWBT, and the other BOCs, are given incentives to cooperate to make local
9 competition truly possible, to partially offset their natural economic incentives to protect
10 their monopoly positions. By insisting, as a condition for entry into in-region
11 interexchange service, that SWBT demonstrate that it has put in place the conditions
12 necessary for local competition to flourish, in practice and not just on paper, the
13 Section 271 process can be used to induce cooperation. This *quid pro quo* is central to
14 the development of local exchange competition.

15
16 **Q. Please discuss your second factor, providing additional competition in interLATA**
17 **markets.**

18 **A. Long-distance entry by SWBT is not just a reward for providing meaningful**
19 **interconnection with local rivals; it has direct implications for long-distance markets.**
20 **If SWBT can be prevented from misusing its bottleneck local monopoly to disadvantage**
21 **its long-distance rivals, then permitting SWBT to enter the long-distance market will**

1 make that market more competitive. One reason to insist that local competition has truly
2 been enabled before granting Section 271 authorization is to reduce the dangers of such
3 misuse.

4 In any overall balancing of impacts on local and long-distance markets, it is important
5 to remember that the long-distance market in the U.S. is currently far more competitive
6 than are local exchange markets served by SWBT. Therefore, the incremental benefits
7 of entry into long distance are likely to be smaller than the corresponding benefits from
8 entry into local exchange.

9 Three considerations limit any benefits to consumers in long-distance markets from
10 SWBT's entry into those markets. First, there is the danger that SWBT will use its
11 bottleneck local monopoly to reduce competition in long distance. Second, the benefits
12 from adding another competitor to the long-distance market are muted in comparison with
13 adding a competitor to a monopolized market. Third, to the extent that SWBT is a
14 reseller of long-distance services rather than a facilities-based competitor, its impact on
15 long-distance markets is less pronounced.

16
17 **Q. How does your third factor, preventing anticompetitive conduct in the provision of**
18 **exchange access, relate to the public-interest standard?**

19 **A.** Just as in the old Bell System, an integrated provider may have economic incentives to
20 use its local exchange bottleneck to disadvantage long distance rivals. Because of this

1 danger, one cannot conclude that entry by a BOC into in-region long-distance markets
2 will necessarily enhance competition in long-distance markets.

3 If regulation is ineffective in preventing discrimination against rival interexchange
4 carriers, BOC entry into long distance actually harms consumers in interexchange
5 markets. Discrimination is especially harmful to consumer welfare and the public interest
6 because it lowers the quality of service that interexchange rivals can provide to their
7 customers, with little or no offsetting cost savings. Economists widely agree that such
8 quality degradation is even more harmful to the public interest than conventional
9 monopoly overcharges with their associated deadweight losses.

10 Of course, the Commission will attempt to prevent discrimination it can detect, and
11 Congress has provided certain safeguards, including the structural safeguards in
12 Section 272 of the Act, to reduce the dangers of discrimination, although the strength of
13 those safeguards remains uncertain as the FCC has yet to implement the Act in this area.
14 But regulation is necessarily imperfect, no matter how energetic and foresightful the
15 regulators, so the prospect of discrimination cannot be discounted. To me, the ongoing
16 danger of discrimination has three implications: (1) the Commission should factor in this
17 danger in evaluating the net benefit or harm to consumers in long-distance markets of
18 SWBT's entry into those markets; (2) if and when SWBT is granted Section 271 authority
19 to provide in-region long-distance service, the Commission will have to be vigilant to
20 prevent discrimination and to act swiftly in response to complaints about discrimination,
21 and respond forcefully when it detects discrimination; and (3) since the danger of

1 discrimination diminishes as CLECs gain greater presence in local markets, protecting
2 competition in long-distance markets provides yet another reason to insist that local
3 competition truly be enabled before certifying checklist compliance or approving any
4 Section 271 application of SWBT.

5
6 **Q. Explain what you mean in saying that the public interest calls for a level playing**
7 **field as markets merge.**

8 **A.** There appears to be an industry consensus that many consumers will value the ability to
9 purchase a wide range of services -- such as local, long distance, and wireless -- from
10 a single vendor. There seems little doubt that many industry participants are planning
11 to market bundles of services. I anticipate that the marketing of bundles of
12 telecommunications services to heavy telecommunications users will be especially intense.
13 As we look ahead to wide-ranging competition and converging markets, firms that are
14 unable to offer key pieces of attractive bundles will be at a competitive disadvantage.
15 Therefore, parity in the ability to bundle services will be important to full competition
16 in the future.

17 Other things equal, the public interest militates against giving one firm or a group of
18 firms a significant head start in offering bundled services, especially if those firms can
19 rapidly gain market share by marketing the bundled services. As Southern New England
20 Telecommunications Corporation has already demonstrated with its 1994 entry into
21 interLATA markets, interLATA entry by ILECs can be achieved swiftly. At SNET's

1 annual meeting in May 1996, SNET's Chairman and CEO Daniel Miglio cited the
2 phenomenal growth in SNET's interstate long distance market share, stating "In two short
3 years, we have built a new \$80 million revenue stream with a lot of opportunity to
4 grow." During this period, SNET enjoyed ten consecutive quarters of earnings growth
5 and a steadily rising stock price. Merrill Lynch has reported that SNET's long distance
6 subsidiary, SNET America, captured 25% of SNET's local customers within two years
7 of entry, despite aggressive competition from AT&T. Along similar lines, the Wall
8 Street Journal reported just days ago that "Since the spring, [GTE] has turned more than
9 half a million of its local customers into long-distance clients, siphoning business from
10 AT&T and MCI, and it is signing up new customers at the rate of more than 6,000 per
11 day", says Chairman Charles R. Lee. (November 5, 1996). In contrast, significant
12 competition in local exchange markets remains unproven, in Oklahoma and elsewhere.
13 Likewise, competition will be distorted if one group of carriers is given preferential
14 treatment in terms of subsidies. Such subsidies can allow one carrier to capture market
15 share from others even if the subsidized carrier is less efficient. This partially
16 undermines one of the attractive features of competition, namely that market success is
17 driven by lower costs and/or superior product quality.

1 **Q. Telecommunications markets in Oklahoma are currently in a state of flux. How**
2 **does that uncertainty enter into your analysis?**

3 **A. In balancing the four economic objectives I described earlier, it is important to remember**
4 **that uncertainty favors deferring Section 271 authority until we can be confident that local**
5 **competition has truly been enabled.**

6 Once approval has been granted, it will be nearly impossible to rescind as a practical
7 matter. On the other hand, if approval is denied, SWBT can put in another application
8 as soon as conditions have changed to warrant approval. When SWBT submits a
9 Section 271 application, this Commission and the FCC should ask whether the public
10 interest is better served by delaying approval until additional conditions are met.

11 Regarding checklist compliance in particular, this observation implies that policy makers
12 should not certify compliance until they are confident that SWBT has truly enabled local
13 exchange competition.

14
15 **Q. How does an economist determine whether local exchange competition has truly been**
16 **enabled?**

17 **A. By far the best proof of the feasibility of local exchange competition is the actual**
18 **presence of facilities-based local competitors, i.e., actual competition over independent**
19 **facilities. The more widespread is local competition, the more it takes place over**
20 **facilities outside the control of the ILEC, and the greater number of actual CLECs, the**

1 more confident we could be that conditions are truly conducive to entry and expansion
2 by CLECs.

3
4 **Q. Why is the presence of facilities-based competition more significant than other modes
5 of competition such as resale or the leasing of elements from SWBT?**

6 **A.** Facilities-based competition is especially important because it demonstrates that CLECs
7 are prepared to make substantial sunk investments to serve the market. Facilities-based
8 competition also is superior to resale competition because it represents far greater
9 competitor independence of the ILEC. Ultimately, for regulation to wither away and be
10 replaced by competition will require the presence of strong, facilities-based competitors
11 to SWBT. Investments in alternative local loop facilities would be especially significant,
12 as these facilities represent a lasting commitment to the local market. Congress expected
13 these investments would be made, and repeatedly gave the example of cable facilities.
14 Facilities-based competitors also represent alternative sources of access services.
15 Resellers do not serve this function. Widespread competition in the provision of access
16 will help ensure that interexchange markets remain competitive after BOC entry.
17 Competition based on the leasing of network elements is not nearly as significant as true
18 facilities-based competition. A CLEC who is leasing elements from the incumbent local
19 exchange carrier clearly remains heavily reliant on the incumbent carrier. Also, sunk
20 investments and commitment to the market associated with leasing network elements are
21 far lower than those required of a CLEC building its own loop plant.

1 Still, leased elements are better than resale in terms of offering competition to the ILEC.
2 First, CLECs who are leasing network elements can offer competition along a number
3 of dimensions that resellers cannot. Second, resale rates are not based on the underlying
4 costs of the facilities, so resale competition does relatively little to drive retail rates down
5 towards cost.

6 I would hope that all parties can agree that resale, while offering valuable competition
7 over some aspects of service (such as marketing, billing, or customer service), is
8 inherently limited and less meaningful than facilities-based competition. The RBOCs
9 themselves pointed this out in their motion to vacate the consent decree, where they
10 stated that resellers "do little to further interexchange competition." (Memorandum of
11 Bell Atlantic, BellSouth, Nynex, and Southwestern Bell in Support of Their Motion to
12 Vacate the Decree, July 6, 1994, p.70)

13
14 **Q. Is there widespread local exchange competition currently in Oklahoma?**

15 **A.** It seems clear from the information submitted by SWBT that actual local competition is
16 currently *de minimis*. Neither AT&T, MCI, nor Sprint yet provides facilities-based or
17 even resold local exchange service in exchanges served by SWBT.

18 However, to my knowledge none of the competitive exchange carriers yet provides a
19 significant competitive alternative to SWBT for exchange services in Oklahoma.
20

1 Q. Are you saying that we must see full competition in local exchange markets before
2 we can conclude that SWBT has in fact fully implemented the checklist?

3 A. No, I understand that this is not the applicable legal standard. But we must see some
4 actual competitors with their own facilities, we must be confident additional entry is
5 imminent, and we must be confident that the ILEC cannot prevent these entrants from
6 competing effectively.

7 In markets subject to rapid technological or regulatory changes, an assessment of
8 competitive conditions cannot be static or backward looking. Even if a market is not yet
9 workably competitive, it may soon become competitive, if conditions are changing in
10 significant, predictable ways that will make entry possible. In such cases, it should be
11 examined whether additional competition is imminent, even if it has not yet arrived.

12
13 Q. What are the economic indicators that competition is imminent?

14 A. One important indicator of imminent competition in local exchange markets is the
15 expenditure of significant non-recoverable (sunk) investments by CLECs. Such
16 investments constitute a vote of confidence that competition is feasible, by those with a
17 direct financial stake in making competition real. For precisely this reason, mere
18 announcements of plans to offer services are far less reliable than actual sunk
19 expenditures.

20 Of course, these investments remain at risk, until it has been proven that the entrants can
21 indeed rely on the ILEC to provide critical inputs. By deferring Section 271

1 authorization until SWBT has demonstrated its cooperation, local competition is
2 enhanced, entrants' investments are partially protected from exclusionary tactics by
3 SWBT, and further investments by CLECs are encouraged.

4 One role the Commission will play is to make sure that these investments are not
5 stranded or devalued by problems implementing interconnection with SWBT.
6

7 **Q. Do all sunk expenditures to provide local telephone services indicate that the entry**
8 **barriers in local exchange markets have been lowered?**

9 **A.** No. In evaluating the significance of sunk investments for assessing market participants'
10 beliefs about the feasibility of local exchange competition, it is important to account for
11 the entire range of services provided by those investments. For example, due to the
12 presence of economies of scope in the provision of access and exchange services, some
13 investments in local facilities may be recoverable through provision of access services,
14 and not reliant on the full range of interconnection necessary to a CLEC. Thus, the
15 presence of sunk investments alone will not suffice.
16

17 **Q. What do economists look for, in addition to actual entry and significant sunk**
18 **investments, to determine whether barriers to entry and effective competition have**
19 **indeed been lowered?**

20 **A.** In addition to examining the state of actual competition, and the tangible commitments
21 made to the market by entrants, economists can directly evaluate the conditions of entry

1 to gauge the height of entry barriers and determine whether potential competition is truly
2 feasible. By identifying entry barriers and assessing their significance, an economist can
3 try to determine whether a number of potential CLECs can reliably and easily offer local
4 exchange service to residential and business customers across the State, and whether
5 competition has effectively been enabled.

6 Economists also look for market conditions that might impede the ability of market
7 participants to compete effectively. After all, even if a firm has invested in the local
8 exchange market and entered that market, its ability to compete and attract customers
9 may still be limited by the ILEC's conduct, e.g., by providing inferior repair and
10 maintenance services.

11
12 **Q. Has entry been enabled if SWBT offers to provide interconnection on "reasonable"**
13 **terms to CLECs?**

14 **A.** No, not until the offered terms have been proven to work in practice, and we are sure
15 that other entrants can replicate these proven arrangements.

16 Due to the complexity and importance of interconnecting in various ways with the ILEC,
17 a CLEC cannot be confident that entry truly has been enabled until interconnection has
18 been shown to work on a commercial scale. In demonstrating that interconnection in its
19 myriad details really works, an interconnection agreement with a CLEC covering a large
20 geographic area is more convincing and more meaningful than an agreement with a
21 highly localized CLEC. Likewise, to give a specific example of one dimension of